

State of California
BOARD OF EQUALIZATION
SALES AND USE TAX REGULATIONS

Regulation 1525.5. MANUFACTURING BY-PRODUCTS AND JOINT-PRODUCTS.

Reference: Sections 6094, 6244, Revenue and Taxation Code.

(a) IN GENERAL. Manufacturers and refiners are consumers of tangible personal property purchased for the purpose of use and consumed in the manufacturing or refining process, including that portion of purchased raw materials that comprise by-products that are produced and consumed during the manufacturing or refining process, or subsequent thereto.

(b) DEFINITIONS.

(1) **Property Purchased.** As used herein the term “property purchased” means materials that have been acquired in a transaction defined as a “purchase” pursuant to Section 6010 of the Revenue and Taxation Code and includes property acquired by purchase from a joint venture of which the manufacturer or refiner is a member.

(2) **Split-Off Point.** The point at which joint products being manufactured or refined become separately identifiable.

(3) **Separable Costs.** All costs incurred to further process and dispose of products and by-products after split-off point.

(4) **By-Products.** As used herein the term “by-products” means products simultaneously produced from the manufacturing process, including joint-products.

(5) **Net Realizable Value.** The market value or sales value of a product or by-product less costs of completion and disposal after split-off point, if any.

(c) COMMINGLED GOODS. When a manufacturer or refiner purchases property for resale, and prior to or during the refining or manufacturing process, physically commingles these materials with property not so purchased of such similarity that the identity of the materials that comprise this commingled mass cannot be determined, by-products that are produced from the mass of commingled goods and consumed shall be deemed to be first consumed from the property not purchased for resale until a quantity of commingled goods equal to the quantity of property not purchased for resale has been consumed.

Any manufacturer or refiner that claims its consumed by-products are not subject to tax, because of the physical commingling of property purchased and property not so purchased, must establish by its records that this commingling occurred prior to such consumption.

(d) REPORTING METHODS.

(1) Manufacturers or refiners that consume by-products that are produced during the manufacturing or refining process from purchased raw material may use any method of cost allocation consistent with generally accepted accounting principles that accurately computes the purchased cost of the consumed raw materials to report their tax liability for the reporting period in which the use was made. The manufacturer or refiner must be prepared to demonstrate by records which can be verified by audit that the method used properly reflects their tax liability.

(2) The following is a description of an approved method that manufacturers and refiners that consume by-products from purchased materials may utilize to compute their tax liability:

(A) Determine the split-off point for by-products that are used.

(B) Determine the net realized values of all products and by-products.

(C) Determine the net realizable value(s) of by-product(s) used.

(D) Divide the net realizable value(s) of by-product(s) used (Step C) by the net realizable values of all products and by-products (Step B) to obtain a taxable ratio.

Regulation 1525.5. (Continued)

(E) Multiply the purchase cost of all raw materials added to the manufacturing or refining process prior to the split-off by the taxable ratio (Step D) to find the measure of the tax liability resulting from the use of by-products.

The following formulas summarize the above steps:

MV = Market Value

PC = Purchase Cost

SC = Separable Costs Beyond Split-Off

bp = By-Products Used

tp = Total Products and by-products

Where no processing is necessary beyond split-off to obtain market value so that MV equals market or sales value at split-off:

MV

$\frac{bp}{tp} \times PC = \text{MEASURE OF TAX}$

MV

tp

Where processing beyond split-off is necessary to obtain market value so that MV equals market or sales value beyond split-off:

MV – SC

$\frac{bp}{tp} \times PC = \text{MEASURE OF TAX}$

MV – SC

tp

Note: MV – SC = Net Realizable Value at Split-Off

(e) To ensure compliance with the provisions of this regulation, manufacturers and refiners are encouraged to obtain approval by the Board prior to adopting a method of calculating their tax liability incurred as a result of the consumption of purchased raw materials produced and consumed during the manufacturing or refining process.

(f) **AUDITS.** Taxpayers using the suggested method or an alternate method that has been approved by the Board will normally be audited by application of the same approved procedure in the audit to verify the accuracy of reported amounts. Determinations may be imposed or refunds granted if the Board, upon audit of the books and records, determines that the amounts reported by return did not accurately disclose the amount of tax due.

History: Adopted February 25, 1985, effective March 27, 1985.

Regulations are issued by the State Board of Equalization to implement, interpret or make specific provisions of the California Sales and Use Tax Law and to aid in the administration and enforcement of that law. If you are in doubt about how the Sales and Use Tax Law applies to your specific activity or transaction, you should write the nearest State Board of Equalization office. Requests for advice regarding a specific activity or transaction should be in writing and should fully describe the facts and circumstances of the activity or transaction.